

CITY OF OAK HARBOR
Island County, Washington
January 1, 1992 Through December 31, 1992

Schedule Of Findings

1. Public Funds Were Misappropriated

Our audit of the financial records of the City of Oak Harbor revealed that at least \$63,883 in public funds was misappropriated during the period January 1, 1991, through September 19, 1993. Accounting records were falsified and destroyed in an attempt to conceal these losses. There were no federal funds involved in this case. These funds were misappropriated as described below.

While the parks director accurately reported daily cash collections to Ms. Bishop, some of these funds were stolen after camper cash receipts were turned in to the finance department. Ms. Bishop prepared cash receipt log sheets which reflected this reduced fund accountability, and turned in these records and funds to the cashier. Camper receipt envelopes were used to determine the amount of funds collected during the period July 7, 1993, through September 19, 1993. However, since all earlier envelopes had been destroyed, the park director's "Route Sheet" was used to determine the camp sites occupied and funds collected during the period January 1, 1991, through July 6, 1993.

As the accounting technician during the period of this loss, Ms. Bishop was responsible for accounting for park cash receipts in the finance department. She opened the envelopes, counted the money, and prepared a cash receipt log sheet by camp site for each day. She then turned in this log sheet and the money to the cashier. Ms. Bishop was relieved from her duties on September 20, 1993, after the police department video taped her irregular cash receipting activities.

RCW 42.20.070 states that:

Every public officer . . . receiving money on behalf or for or on account of the people of the state . . . or for or on account of any county, city, town, or any school, diking, drainage, or irrigation district, who:

1. Shall appropriate to his or her own use or the use of any person not entitled thereto, without authority of law, any money so received by him or her as such officer or otherwise; or
2. Shall knowingly keep any false account, or make any false entry or erasure in any account, of or relating to any money so received by him or her; or
3. Shall fraudulently alter, falsify, conceal, destroy or obliterate any such account; or
4. Shall willfully omit or refuse to pay over to the state, its officer

or agent authorized by law to receive the same, or to such . . .
city . . . any money received by him or her as such officer
when it is a duty imposed upon him or her by law to pay over
and account for the same,

shall be punished by imprisonment in a state correctional facility for not
more than fifteen years.

Poor controls over receipt of camp site fees allowed this misappropriation to occur. Money in the receipt envelopes was turned over to one finance employee who was allowed to open these envelopes and count the money alone. There was no oversight of the money count by a second employee, nor was anyone held accountable for depositing the amount of money that corresponded to the receipt envelopes turned in to the finance department.

We recommend the City of Oak Harbor seek recovery of the misappropriated \$63,883 and related audit/investigation costs from their insurance bonding company. We further recommend the Washington State Office of the Attorney General and the Island County Prosecuting Attorney review this matter and take whatever action is deemed appropriate under the circumstances. Any compromise or settlement of this claim must be approved in writing by the Attorney General and the State Auditor as directed by RCW 43.09.260.

Bond coverage for the accounting technician is as follows:

Employee Honesty Bond

Insurance Company:	Aetna Life & Casualty
Coverage Period:	2/12/93 - 2/12/96
Coverage Limit:	\$50,000

We also recommend management improve controls over receipt of money from the city park, to ensure accountability is established over the money turned in, and oversight is provided by finance management to ensure that the amount of documented receipts agrees with the amount deposited in the city's bank account.

2. City Officials Should Bill All Utility Customers In Accordance With Approved Rate Schedules

During our audit of the City of Oak Harbor we reviewed evidence gathered by the finance department for the billing history of two utility customers. This evidence shows that these customers were routinely billed less than the amount prescribed by ordinance for garbage services. In fact, from January 1991 through July 1993, these customers were billed a total of \$8,949 less than the amount prescribed by ordinances Numbers 808 and 908, in effect during that time. This not only violates city ordinance, it also represents a gift of public funds.

Article VIII, Section 7 of the state constitution states in part:

No city, county, town or other municipal corporation shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company, or corporation

This condition occurred even though automated bills were calculated by the computer system after input of meter readings, because the automated billings were disregarded so manual billings could be calculated and sent to these customers. The manual billings were less than the rates required by city ordinance. City officials stated that the finance department employee responsible for preparing utility billings was solely responsible for under billing these customers.

Under billing utility customers results in a loss of revenue to the city's garbage utility, as well as a violation of city ordinance and state law. More importantly, when only select customers are under billed, confidence in the billing system is undermined for all customers.

We recommend that city management: (a) provide oversight in the utility billing process to ensure any manual or nonroutine bills are accurate and (b) notify the insurance bonding company of the loss of funds.

3. Record Of Water Meter Readings Should Be Retained

During our audit of the controls over utility billings we learned that some of the original records of water meter readings in 1992 were not retained.

Two basic types of records exist to support the city's meter readings.

- a. For those accounts where a computer file exists, meter reading reports are generated to show the usage read by an electronic versaterm storage unit. These reports represent the original source document of the actual water usage. Usage figures are shown in customer account history files, however, these figures can be adjusted and it is necessary to have the report of actual meter readings for comparison to ensure customers are billed for correct usage.
- b. For those accounts not set up on the utility billing software, a handwritten manual meter reading is the only original documentation.

The time periods for which these two types of records were missing was different. The explanation follows.

Meter reading reports for accounts set up in the billing system were not retained for January through April 1992.

Handwritten records of manual meter readings were not retained for all of 1992, nor were any kept for the first half of 1993.

As authorized by RCW 40.14.050, records retention schedules for use by state and local government are established by the Records Committee, which is composed of representatives from the offices of State Archivist, State Auditor, and State Attorney General. The records retention schedule for water and sewer utilities requires that "meter books", or whatever serves as evidence of the readings taken from individual meters, be kept for at least three years.

When source documents to support customer water meter readings are not retained, we cannot gain adequate assurance that utility customers are being billed the proper amount.

We were able to gain adequate assurance through other means that the utility revenue and accounts receivable amounts as a whole on the financial statements are presented fairly in all material respects for 1992. However, failure to keep adequate source documentation could lead to future problems in financial reporting.

We recommend city officials retain all source documentation to support utility billings as required by state records retention schedules.

4. The City Should Limit Investments To Those Authorized By State Law And Take Necessary Steps To Safeguard All Investments

During our audit of the city's cash and investments for 1992 we noticed three conditions which require disclosure.

- a. At December 31, 1992, the City of Oak Harbor held \$2,282,895 of investments in mutual funds. Mutual funds are not legal investments for a city, except when investing money subject to the arbitrage provisions of section 148 of the federal internal revenue code.
- b. Also as of December 31, 1992, the city held a \$95,000 Certificate of Deposit (CD) with Bank of New England, purchased through a broker. Certificates of deposit with an out of state bank, not completely covered by FDIC insurance, are also not eligible investments.
- c. Finally, at December 31, 1992, the city invested \$1,136,650 in a Repurchase Agreement with First Interstate Bank (REPO), set to mature on January 4, 1993. According to the bank statement for December, this REPO was collateralized by a Student Loan Marketing Association security (SLMA). This would ordinarily be adequate collateral for a REPO; however, the city had no evidence that this security was in their name or that it was held by an independent third party, such as the bank's trust division or a separate bank acting as safekeeping agent. In properly secured REPO transactions, if the bank does not honor their agreement, the city's recourse is to sell the underlying security which acts as collateral. In this case, since the city did not have the underlying security listed in their name and held in trust by a third party, the entire amount of REPO investment was without proper collateral and therefore at risk of loss.

RCW 35.39.030 states:

Every city and town may invest any portion of the moneys in its inactive funds or in other funds in excess of current needs in:

- (1) United States bonds;
- (2) United States certificates of indebtedness;
- (3) Bonds or warrants of this state;
- (4) General obligation or utility revenue bonds or warrants of its own or of any other city or town in the state;
- (5) Its own bonds or warrants of a local improvement district which are within the protection of the local improvement guaranty fund law; and
- (6) In any other investments authorized by law for any other taxing districts.

Neither mutual funds or out of state certificates of deposit are authorized investments under the above statute.

RCW 39.59.030 addresses investment in mutual funds of arbitrage moneys only, and states

that cities may only invest in mutual funds using money:

. . . eligible for investment and subject to the arbitrage provisions of section 148 of the federal internal revenue code or similar provision concerning the investment of state and local money . . .

The city's finance management invested in mutual funds in 1992. The out of state CD was purchased in December 1990. Both of these types investments were liquidated in 1993. The city has routinely invested funds for one to four days in REPOs. That type of investment stopped in 1993 as well.

Investment laws for municipalities are written to protect public funds from loss. In this case the mutual funds were not adequately protected from loss. For mutual funds, the city owns no underlying security to serve as collateral in the event it does not receive its principal from the broker when selling shares of the mutual fund. The CD having been purchased through a broker was actually part of a larger CD, and because of this the city shared the FDIC guarantee with holders of other parts of the whole certificate.

As explained above, while the REPO was a legal investment for the city, the manner in which it was made did not adequately protect the funds invested.

We recommend the city limit investments to those authorized under state law and take necessary steps when making all investments to safeguard public funds.

5. The City Should Balance Cash In The General Ledger To Bank Statements

While auditing cash at December 31, 1992, we found that the city's cash according to the general ledger and financial statements did not agree with reconciled bank statements and confirmations for pooled investments of cash. The city is reporting \$43,127 more than it can substantiate with bank records.

Without a reconciliation from cash on the city's books to amount in the bank records, we could not gain adequate assurance that cash is presented fairly on financial statements at December 31, 1992.

A change in finance management caused problems in performing this reconciliation.

We recommend the city dedicate the necessary resources to reconcile their cash account to bank records, to ensure cash will be presented fairly in the future.

6. City Officials Should Improve Internal Accounting Controls Over Fixed Assets

Our review of the city's fixed assets revealed the following weaknesses in internal controls:

- a. The city does not maintain a detailed asset ledger for the general fixed asset account group.
- b. City officials do not take a physical inventory of the city's assets on a regular basis.

As a result of the absence of a fixed asset ledger for the general fixed asset account group, we were unable to apply audit procedures to verify the validity of these fixed asset balances. Consequently, we consider this condition to be a material weakness in internal control for financial reporting purposes.

We recommend that city officials:

- a. Establish and maintain a detailed fixed asset subsidiary ledger for the general fixed asset account group. All additions and retirements of fixed assets should be recorded in this ledger as they occur. The ledger should be reconciled to the general ledger control account in a timely manner.
- b. Perform a comprehensive annual physical inventory of fixed assets, including land, buildings and improvements, and equipment. Any differences between the physical inventory, the fixed assets subsidiary ledger, and the general ledger accounts should be resolved.

7. Annual Reports Should Be Prepared In A Timely Manner

The City of Oak Harbor's annual report was not prepared in a timely manner as prescribed by state law. The final draft of all the city's 1992 general purpose financial statements was not available for audit until December 1993.

RCW 43.09.230 states in part:

. . . The state auditor shall require from every taxing district and other political subdivisions, financial reports covering the full period of each fiscal year, in accordance with the forms and methods prescribed by the state auditor, which shall be uniform for all accounts of the same class.

Such reports shall be prepared, certified, and filed with the division within one hundred fifty days after the close of each fiscal year.

In addition, the Office of Management and Budget (OMB) requires that in accordance with OMB Circular A-128, Section 13, Paragraph F, the city's annual report be audited and submitted within 12 months after the end of the fiscal year.

The city's delay in preparing their 1992 financial report resulted in our not being able to complete the audit report in time to comply with federal requirements.

Without timely financial reporting, city officials have not discharged their statutory and fiduciary responsibilities. In addition, a delay such as this results in increased costs to the city to complete the audit and a delay in issuing the audit report.

The delay in preparation of the annual report occurred because of personnel changes and the reconstruction of prior year balances.

We recommend that the city's management assign appropriate priority to the preparation of an accurate and timely annual report to ensure they meet their fiduciary responsibility and to ensure compliance with state law.

8. Annual Street Cost Report Should Be Prepared In A Timely Manner

The city's annual street cost report for 1992 was not prepared until January of 1994. This report provides information concerning street revenues, expenditures and operations for the year.

RCW 35.21.260 states:

The governing authority of each city and town on or before March 31st of each year, shall submit such records and reports regarding street operations in the city or town to the secretary of transportation on forms furnished by him, as are necessary to enable him to compile an annual report thereon.

As a direct effect of changes in the city's financial management personnel, the annual street cost report was not given the necessary priority.

When the city's street report is not prepared in a timely manner, the annual report that is prepared by the State Department of Transportation is based upon incomplete data.

We recommend that the annual street cost report be prepared as required by state law.